

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

Re Proposing Release: Amendments to PCAOB Auditing Standards related to a Company's Noncompliance with Laws and Regulations and Other Related Amendments; PCAOB Rulemaking Docket Matter No. 051

Dear Office of the Secretary:

This letter represents our personal views as the Chief Financial Officer and the Chief Accounting Officer of Novanta Inc. regarding the PCAOB's Proposing Release: *Amendments to PCAOB Auditing Standards related to a Company's Noncompliance with Laws and Regulations and Other Related Amendments (the "Proposed Amendments")*.

We support the PCAOB's mission to protect investors by modernizing auditing standards that support the performance of continued high-quality audits in today's complex business environment. However, we are concerned that the Proposed Amendments do not advance that mission. On the contrary, they risk reducing audit quality and lessening investor protections while increasing materially the cost and complexity of financial statement audits.

We share the concerns raised by PCAOB Board Members Duane DesParte and Christina Ho in the PCAOB's June 7, 2023 open meeting.¹

Specifically, we are concerned that:

- The Proposed Amendments are too broad in scope.
- The Proposed Amendments do not sufficiently consider a company's existing compliance function and the shared responsibility of the board of directors, the audit committee, the executive officers, and the general counsel.
- Auditors are not lawyers and, as a result, the Proposed Amendments would expand the role of auditors to include knowledge and expertise outside of their core competencies.
- The Proposed Amendments would substantially increase the time and cost of the audit for both auditors and public companies without a commensurate benefit.
- The Proposed Amendments would have an unintended consequence of creating unfair and undue economic burden for small to mid-sized publicly traded companies in the U.S., putting these companies at a competitive disadvantage economically.

We believe that:

1. Any change should keep the auditor focused on noncompliance of laws and regulations that have a direct and material impact on the financial statements, such as material penalties or loss contingencies.

¹ See public statements from Board Members Duane DesParte and Christina Ho.

2. Any requirement of the auditor should be risk-based and consider the role that a company's compliance program plays in detecting noncompliance with laws and regulations that could be material to the audited financial statements.

To expand upon our views, we offer the following rationale:

The Proposed Amendments are too broad in scope.

The proposed requirement that auditors identify "laws and regulations with which noncompliance could reasonably have a material effect on financial statements"² is duplicative and unnecessary. Given that public companies are subject to a vast number of laws and regulations, and the largest companies in highly regulated industries can be subject to hundreds of new laws and regulations every year, they already have extensive compliance processes to perform this exact function. The results of those processes are regularly reported to audit committees, as well as to external auditors for their input regarding the process and evaluation of any significant matters. According to a recent survey, the top three detection methods of frauds (approximately 70%) were as a result of tips, internal audit, and management review.³

The Proposed Amendments require that auditors design and perform procedures aimed at identifying whether there is information indicating that noncompliance with relevant laws and regulations has or may have occurred and, if so, the auditor must obtain an understanding of the nature and circumstances of such noncompliance and determine whether it is likely that any such noncompliance occurred. Such requirements would inevitably cause auditors to materially expand their audit procedures that would cause both auditors and public company management to expend undue amount of time and resources to evaluate noncompliance matters that potentially have no or insignificant financial statement impact, because auditors would be obliged under the Proposed Amendments to assure themselves that the matters do not have a material impact, document their assessment and conclusions, and prepare the required communications to company management and/or the board of directors and the audit committee. We believe these requirements go well beyond the scope of financial statement audits and should be considered an overreach. The Proposed Amendments would have the effect of misplacing the role of a legal compliance watch dog on the shoulders of financial statement auditors, which could lead to false investor expectation that (i) financial statement auditors are providing assurance on a company's compliance with laws and regulations and (ii) an audit is designed to provide absolute assurance that financial statements are free of misstatements from errors or noncompliance with laws and regulations.

Further, the expectation that auditors focus on all types of noncompliance, whether the violations concern financial or operational issues or involve intentional or unintentional conduct, expands the auditors' responsibilities beyond the boundaries of financial statement audits. This will cause auditors to dramatically expand their audit procedures which will lead to material increases in costs for both audit firms and public companies at large. We believe that the overall increases in costs would significantly outweigh the perceived benefits.

² See proposed AS 2405.06.

³ See ACFE report, *Occupational Fraud 2022: A Report to the Nations*.

The Proposed Amendments do not sufficiently consider a company's existing compliance function and the shared responsibility of the board of directors, the audit committee, the executive officers, and the general counsel.

We believe that it takes company management, audit committees, auditors, and regulators working in concert to foster a system that supports both high-quality financial statements and audits, all for the protection of investors. Oversight of a company's compliance with laws and regulations is primarily the shared responsibility of the board of directors, the audit committee, the executive officers, and the general counsel. We believe a better approach could be one that is risk-based, and where the auditor considers the role the company's compliance program plays in detecting non-compliance with laws and regulations that could be material to the audited financial statements. We also believe that the existing audit standard appropriately describes auditor responsibility in this regard.

The proposed requirement for the auditor to “develop appropriate audit responses to risks of material misstatement due to noncompliance with [...] laws and regulations and to identify whether there is information indicating noncompliance with those laws and regulations has or may have occurred”⁴ would lead to costly over-expansions of audit procedures that would lead to little benefit to public companies or the effectiveness of financial statement audits.

Auditors are not lawyers.

In addition to being unnecessary and burdensome, the Proposed Amendments would expand the auditor's role to include skills, knowledge, and expertise outside the auditor's core competencies and expertise. Although experts could be added to audit teams to bridge some of the gaps in knowledge and skills, this is an unrealistic and unreasonable expectation placed on audit firms. Such an expectation would also lead to the undesirable consequence of stamping out healthy competition amongst audit firms as smaller firms will not have the wherewithal to bridge the gaps in knowledge and skills in order to continue to perform audits of publicly traded companies. We believe that the teams of in-house attorneys and outside counsel employed by publicly traded companies are better suited to monitor, identify, and investigate potential violations of laws and regulations.

The Proposed Amendments will substantially increase the cost of the audit without a commensurate benefit.

The PCAOB acknowledges in its proposal that auditors may need to retain a range of legal experts to comply with the proposed standards but offers no projected cost beyond “[t]hese costs could be substantial.” Additional efforts should be made to study the costs and benefits of the Proposed Amendments.

The legal experts retained by auditors will have no attorney-client privilege with the company, thus risking disclosure of their analyses. Because the Proposed Amendments would require auditors to make additional inquiries regarding any communication around noncompliance of laws and regulations, they would create tension on the attorney-client privilege between the company and its own legal counsel, who will also face increased demands for information and analysis from the auditors. That tension is counter-productive to the PCAOB's goals in these Proposed Amendments because it may have a chilling effect on attorney-client communications out of the fear of waiver of attorney-client privilege.

⁴ PCAOB Release No. 2023-003, June 6, 2023, Page 22.

Over the years, public companies have experienced material increases in audit fees as a result of increased audit procedures following various PCAOB rule updates and PCAOB reviews of audit engagements at public accounting firms registered with the PCAOB. If the Proposed Amendments are adopted, publicly traded companies and their shareholders will bear the ultimate cost of an overreach of audit procedures and getting auditors educated on laws and regulations that are not meant to be in their skillsets. The Proposed Amendments would require auditors to police public companies' compliance with laws and regulations throughout the year, which will add materially to both the time and cost of the audit to both the auditors and their public-company clients. As the Proposed Amendments will be applicable to every public company audit, we would encourage the PCAOB to conduct a thorough economic analysis to understand the cost/benefit tradeoff. The right comparison should be the total incremental costs to be borne by all public companies and their shareholders as a whole versus the probable loss to shareholders of companies as a consequence of their auditors' failures to identify and flag noncompliance of laws and regulations.

The Proposed Amendments would have an unintended consequence of creating unfair and undue economic burden for small to mid-sized publicly traded companies in the U.S., putting these companies at a competitive disadvantage economically.

Unlike large companies, small to mid-sized companies have significantly lower overall materiality thresholds associated with their financial statement audits. As a result, there would be a disproportionate expansion of audit procedures that the auditors would be obliged to conduct at these companies in order to obtain sufficient audit assurance that there is no noncompliance with laws and regulations. The concern for being found deficient in a PCAOB audit engagement quality review has caused public accounting firms to significantly expand their audit procedures but may not have enhanced the audit effectiveness overall. However, public companies and their shareholders have had to bear all the increases in audit costs as a consequence. Additionally, public companies would have to add more internal resources to supplement existing controls and related documentation in order to pass an audit. We also believe this disproportionate negative economic impact would be even more pronounced for small to mid-sized public companies that operate in more diverse technology and market spaces and geographic areas.

We appreciate the opportunity to share our views.

Sincerely,

/s/ Robert Buckley

Robert Buckley
Chief Financial Officer
Novanta Inc.

/s/ Peter Chang

Peter Chang
Chief Accounting Officer and Corporate Controller
Novanta Inc.